

MISSOURI STATE AUDITOR'S OFFICE FISCAL NOTE (11-39)

Subject

Initiative petition from Marc Ellinger regarding a proposed amendment to Chapter 149 of the Revised Statutes of Missouri. (Received May 13, 2011)

Date

June 2, 2011

Description

This proposal would amend Chapter 149 of the Revised Statutes of Missouri.

The amendment is to be voted on in November, 2012.

Public comments and other input

The State Auditor's office requested input from the **Attorney General's office**, the **Department of Agriculture**, the **Department of Economic Development**, the **Department of Elementary and Secondary Education**, the **Department of Higher Education**, the **Department of Health and Senior Services**, the **Department of Insurance**, **Financial Institutions and Professional Registration**, the **Department of Mental Health**, the **Department of Natural Resources**, the **Department of Corrections**, the **Department of Labor and Industrial Relations**, the **Department of Revenue**, the **Department of Public Safety**, the **Department of Social Services**, the **Governor's office**, the **Missouri House of Representatives**, the **Department of Conservation**, the **Department of Transportation**, the **Office of Administration**, the **Office of State Courts Administrator**, the **Missouri Senate**, the **Office of the State Public Defender**, the **State Treasurer's office**, **Greene County**, **Jackson County Legislators**, **St. Louis County**, the **City of Jefferson**, the **City of Kirkwood**, the **City of St. Louis**, **Hannibal 60 School District**, **Rockwood R-VI School District**, **Metropolitan Community College**, and **University of Missouri**.

Assumptions

Officials from the **Attorney General's office** indicated they assume that any potential costs arising from the adoption of this proposal can be absorbed with existing resources.

Officials from the **Department of Agriculture** indicated there will be no impact on their department.

Officials from the **Department of Economic Development** indicated there will be no impact on their department.

Officials from the **Department of Higher Education** indicated that the proposal contained in this initiative petition would have no direct, foreseeable fiscal impact on their department.

Officials from the **Department of Health and Senior Services** indicated:

This proposal, if passed, would increase the tax on cigarettes by \$1.00 per pack for tobacco manufacturers that did not sign on to the Tobacco Master Settlement agreement. This will result in an unknown increase of total state revenue to be deposited in the Healthy Missouri Fund.

This initiative petition would impose a supplemental tax of \$1.00 per pack of 20 cigarettes on the cigarettes of non-participating manufacturers. This tax would be in addition to any other tax currently levied on cigarettes. The revenues from this tax would be deposited into the Healthy Missouri Fund and used to fund: 1) tobacco education; 2) tobacco cessation; and 3) the Attorney General's cost for administration and enforcement of the Tobacco Master Settlement Agreement. A portion of the revenue deposited into the Healthy Missouri Fund may be appropriated to the Department of Health and Senior Services (DHSS) to provide tobacco education and cessation programs.

The Initiative Petition does not state which department(s) will receive monies deposited in the Healthy Missouri Fund. However, the DHSS assumes a portion of the funding may be provided to the department to implement/fund tobacco education and tobacco cessation programs. If a portion of the revenue is allocated to the DHSS, the department could use the monies to fund cessation efforts such as the Missouri Tobacco Quitline and could have funding for tobacco prevention and education efforts aimed at keeping youth from starting tobacco use and getting adults to quit. The amount of money the DHSS would receive to implement tobacco related program(s) is unknown.

Officials from the **Department of Insurance, Financial Institutions and Professional Registration** indicated the petition, if passed, will have no cost or savings to their department.

Officials from the **Department of Mental Health** indicated this proposed initiative petition should have no fiscal impact to their department.

Officials from the **Department of Natural Resources** indicated they would not anticipate a direct fiscal impact from this initiative petition.

Officials from the **Department of Corrections** indicated there will be no impact for their department due to this initiative petition.

Officials from the **Department of Revenue** indicated:

Several state agencies receive funding from cigarette sales. If the number of cigarettes sold decreases, Jackson County and St. Louis County may be negatively impacted as each have a cigarette tax. If passed, the legislation would place a \$1.00 supplemental tax on all non-participating manufacturers' cigarettes. This legislation would increase state revenue.

Based upon sales of approximately 550 million stamps during FY10 this would mean that about \$104 million stamps would have been for non-participating manufacturers.

This supplemental tax would raise approximately \$101 million (based upon a 3% allowance for stamping).

Summary of the proposed petition changes to Section 149.220

- A supplemental tax imposed on tobacco products, a supplemental tax upon the purchase, storage, use, consumption, handling, distribution, or wholesale sale of nonparticipating manufacturer cigarettes will be imposed at \$1.00 per pack.
- The wholesaler will pay the tax and the department will collect the tax.
- Revenues generated by this tax will be deposited in the Healthy Missouri Fund and used for:
 - Funding tobacco education in Missouri,
 - Funding tobacco cessation programs in Missouri, and
 - Funding enforcement and administration of the Master Settlement Agreement by the Attorney General.
- Nonparticipating manufacturer will have the same meaning as the term defined in Section 196.1020.

Detailed estimated revenue calculation

During fiscal year 2010, approximately 19 percent (18.91%) of cigarette sales were from non-participating manufacturers. Based upon sales of approximately 550 million (549,836,000) stamps during FY10, approximately 104 million stamps ($550 \times .1891$) were stamps affixed to non-participating manufacturer cigarette packs.

If a similar amount of stamps are sold following the effective date of this statutory change, this supplemental tax could annually raise approximately \$101 million based upon a three percent (3%) allowance for stamping. Department officials indicated they are unable to determine if the increase in tax would contribute to a loss of sales of non-participating manufacturer's cigarettes, or if there would be decreased revenue from stockpiling product in advance of the increase if no language is added to prevent the addition of the tax to current inventory of retailers.

Expected implementation changes and costs

The department will need to create / change ordering and reporting forms.

Changes to the Peachtree accounting program would need to be made.

The Department of Revenue would need to notify the 120 licensed cigarette wholesalers of the rate increase. Sufficient time would be needed to ensure that they are able to purchase the new stamps in advance of the effective date. (120 Mailings x \$0.505= \$60.60)

Department officials provided the following additional comments:

- This legislation does not specify an effective date. Department officials recommend an effective date of July 1, 2013 be added to the proposed legislation.
 - At a minimum, department officials said they would need 3 months to provide for contracting and printing of new tax stamps.
 - In addition, tax stamps for the fiscal year may have already been purchased and this would allow for properly allocating the ordering of the new stamps in the next FY budget.
 - An effective date is also needed to ensure that cigarette wholesalers have sufficient time to acquire the new stamps.
- Changes may be needed to Chapter 149 to ensure that all penalty provisions provided in the chapter apply to the new section.
- Currently the Department of Revenue stocks and sells nine (9) tax stamps:
 1. State Only 20's – 4,000 roll,
 2. State Only 20's – 30,000 roll
 3. State only 25's – 4,000 roll
 4. State/St. Louis County 20's – 4,000 roll
 5. State/St. Louis County 20's – 30,000 roll
 6. State/St. Louis County 25's – 4,000 roll
 7. State/Jackson County 20's – 4,000 roll
 8. State/Jackson County 20's – 30,000 roll
 9. State/Jackson County 25's – 4,000 roll.
- 10. Department officials said they would need an additional nine (9) new stamps for wholesalers to use when stamping non-participating manufacturer cigarettes.
- Department officials recommend adding verbiage requiring that wholesalers be required to affix the proper stamp on all sales of non-participating manufactures' on the effective date and that retailers be prohibited from adding the supplemental tax to any product in their inventory as of the effective day. This would prevent big retailers from stockpiling product to try and reap a windfall when the supplemental tax rate goes into effect. (See suggested language below).

- Each licensed wholesaler shall ensure that on all sales of non-participating manufacturer cigarettes made on or after the effective date, the proper non-participating manufacturer stamp is affixed and any wholesaler that fails to affix the proper stamp shall be subject to the penalty provisions as provided for in 149.051.
- Retailers shall be prohibited from adding the supplemental tax to the price of non-participating manufacturer cigarettes in their inventory as of the effective date of this legislation unless the packs of cigarettes have the proper stamp affixed.

Officials from the **Department of Public Safety** indicated they assume this proposal will have no fiscal impact.

Officials from the **Missouri House of Representatives** indicated there is no fiscal impact to their agency.

Officials from the **Department of Conservation** indicated that no adverse fiscal impact to their department would be expected as a result of this proposal.

Officials from the **Department of Transportation** indicated they anticipate no fiscal impact from this initiative petition.

Officials from the **Office of Administration** indicated:

This proposal imposes an additional tax of \$1 per pack of 20 cigarettes produced by nonparticipating manufacturers (NPMs) as this term is defined in Section 196.1020 RSMo. These revenues are deposited in the Healthy Missouri Fund¹ to be used for tobacco education, tobacco cessation programs, and enforcement and administration of the Master Settlement Agreement.

The proposed amendment to the Revised Statutes of Missouri should not result in additional costs or savings to the Office of Administration should it be approved by the voters.

The Division of Budget and Planning (BAP) calculates the impact of the tax increase by estimating the quantity of packs currently sold, applying the midpoint formula for elasticity to estimate the new quantity of packs, then calculating increased revenues.

¹ Technical Comment: Currently, there is no Healthy Missouri Fund existing in state statutes. BAP assumes the intent is to establish the Healthy Missouri Fund in the state treasury.

BAP notes the following:

1. BAP estimates the current retail price of one cigarette pack is \$4.50 = \$4.33 price + \$0.17 excise tax.² Given the nature of the proposal and anecdotal information, it is likely the price of NPM cigarettes is less than this.
2. This analysis does not include additional impacts of any retail sales taxes.
3. The website "Tobacco Free Kids" estimates the average cigarette tax as \$1.45 per pack, as of August 3, 2010.³ A tax of \$1.17 (the proposed \$1 plus the existing tax of \$0.17) would be below this average, but would exceed the tax rate of every neighboring state except for Iowa (\$1.36).
4. State cigarette taxes in FY10 totaled \$91,151,815, according to the DOR.⁴
5. A recent ratings report by Standard & Poor's estimates the market share of NPM cigarettes is about 7%.⁵ The DOR reports to BAP that, according to internal data, NPMs comprise approximately 19% of purchases of cigarette stamps.
6. "Elasticity" is the ratio of the change in quantity sold to the change in price. The CDC estimates the cigarette price elasticity as -0.4,⁶ which suggests a 4% drop in sales for each 10% increase in cost. However, research by Goolsbee (2004)⁷ demonstrates the elasticity for state cigarette taxes likely exceeds -1.2, and could exceed -2.0, depending on internet access.
7. Given the above estimate, and considering the ease with which in-state consumers could substitute cigarettes made by other manufacturers, the likelihood of lost purchases by out-of-state consumers, and the possibility that retailers might stockpile cigarettes at the lower tax rate, BAP surmises the elasticity could exceed -2.0.
8. This analysis uses the midpoint-method to estimate the new quantity (Q2) of cigarette packs taxed as a result of the tax increase: $E = \{(Q2-Q1) / \text{AVG}(Q2,Q1)\} / \{(P2-P1) / \text{AVG}(P2,P1)\}$

Based on this information, BAP uses the midpoint formula described above with these assumptions: retail price of \$4.50, 7% market share for NPMs, and elasticity of -1.2. This leads to an estimated revenue increase of \$28.1M, as presented in Table 1.

² "Tax Burden on Tobacco, FY 2010,"

http://nocigtax.com/upload/file/148/Tax_Burden_on_Tobacco_vol._45_FY2010.pdf, accessed May 17, 2011.

³ <http://www.tobaccofreekids.org/research/factsheets/pdf/0222.pdf>, accessed May 16, 2011.

⁴ <http://dor.mo.gov/pdf/financialstatreport10.pdf>

⁵ Standard & Poor's Ratings Direct, August 24, 2010, accessed May 16, 2011.

<http://www2.standardandpoors.com/spf/pdf/events/SFTcon81010Article2.pdf>

⁶ http://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/index.htm, accessed May 16, 2011.

⁷ <http://faculty.chicagobooth.edu/austan.goolsbee/research/cigsdraft.pdf>, accessed May 16, 2011

Table 1.

	Current (FY10)	New
Tax (per pack)	\$0.17	\$1.17
Estimated Cost Per Pack	\$4.50	\$5.50
Estimated Packs with Tax Increase, using Midpoint Formula		
FY10 Revenues		\$91,151,815
FY10 Revenues from NPMs	7%	\$6,380,627
P1		\$4.50
P2		\$5.50
Q1		37,533,100
Estimated Elasticity		-1.2
Q2		29,490,293
Total Revenues		\$34,503,643
Increased Revenues		\$28,123,016

Alternative values for the retail price, market share, and elasticity could be \$3.50, 19%, and -2.0 respectively, based on the discussion above. Table 2 presents estimated increases using the various combinations of these variables.

Table 2.

Option	Market Share	Elasticity	Retail Price	Estimated Increase
1	7%	-2.0	3.50	\$19,967,609
2	7%	-2.0	4.50	\$22,895,191
3	7%	-1.2	3.50	\$26,077,346
4	7%	-1.2	4.50	\$28,123,016
5	19%	-2.0	3.50	\$54,197,797
6	19%	-2.0	4.50	\$62,144,091
7	19%	-1.2	3.50	\$70,781,366
8	19%	-1.2	4.50	\$76,333,901

The results are sensitive to the assumed levels of the variables, particularly the market share, but BAP does not have further data indicating which combination of levels is the most applicable for this analysis. Therefore, BAP estimates the impact of this proposal to be an increase of \$20.0M to \$76.3M for the newly created Healthy Missouri Fund.

Officials from the **Office of State Courts Administrator** indicated there will be no fiscal impact on the courts.

Officials from the **Missouri Senate** indicated this initiative appears to have no fiscal impact as it relates to their agency.

Officials from the **Secretary of State's office** indicated their office is required to pay for publishing in local newspapers the full text of each statewide ballot measure as directed by Article XII, Section 2(b) of the Missouri Constitution and Section 116.230-116.290, RSMo. The Secretary of State's office is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. Funding for this item is adjusted each year depending upon the election cycle with \$1.3 million historically appropriated in odd numbered fiscal years and \$100,000 appropriated in even numbered fiscal years to meet these requirements. The appropriation has historically been an estimated appropriation because the final cost is dependent upon the number of ballot measures approved by the General Assembly and the initiative petitions certified for the ballot. In fiscal year 2011, at the August and November elections, there were 6 statewide Constitutional Amendments or ballot propositions that cost \$1.02 million to publish (an average of \$170,000 per issue). Therefore, the Secretary of State's office assumes, for the purposes of this fiscal note, that it should have the full appropriation authority it needs to meet the publishing requirements.

Officials from the **Office of the State Public Defender** indicated this initiative petition will not have any significant impact on their office.

Officials from the **State Treasurer's office** indicated this initiative petition would have no immediate fiscal impact on their office. Please defer to the Department of Revenue and the Office of Administration.

Officials from the **City of Jefferson** indicated the city estimates no fiscal impact if this ordinance become law.

Officials from the **City of Kirkwood** indicated on behalf of Chief Administrative Officer Michael Brown, there is no financial impact on Kirkwood assuming that the existing tax rate paid to the City is not reduced or eliminated.

Officials from **Hannibal 60 School District** indicated they do not believe this initiative petition will have a cost or cost savings to their school district. If there is any affect at all, they would hope funding would be available should school districts be requested to assist with tobacco education.

Officials from **Rockwood R-VI School District** indicated the district anticipates no financial impact from this initiative petition.

Officials from **Metropolitan Community College** indicated this petition would have no direct fiscal impact on their college.

The State Auditor's office did not receive a response from the **Department of Elementary and Secondary Education**, the **Department of Labor and Industrial Relations**, the **Department of Social Services**, the **Governor's office**, **Greene County**, **Jackson County Legislators**, **St. Louis County**, the **City of St. Louis**, and **University of Missouri**.

Fiscal Note Summary

Estimated additional revenue to state government from this proposal is \$20 million to \$100 million annually with limited estimated implementation costs. The revenue will fund only programs and actions allowed by the proposal. No costs or savings are expected for local governments. Any possible change in revenue for local governments is unknown.